No. 17-16208

IN THE
UNITED STATES COURT OF APPEALS
FOR THE NINTH CIRCUIT

CHARLES E. WHITE, JR., et al.,
Plaintiffs-Appellants,

and

CHEVRON CORP., et al.,
Defendants-Appellees.

On Appeal from the United States District Court
for the Northern District of California
No. 4:16-CV-00793-PJH
Hon. Phyllis J. Hamilton

BRIEF FOR THE CHAMBER OF COMMERCE OF THE UNITED STATES OF AMERICA AND THE AMERICAN BENEFITS COUNCIL AS *AMICI CURIAE* IN SUPPORT OF DEFENDANTS-APPELLEES AND AFFIRMANCE

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INTEREST OF THE *AMICI CURIAE*

The **Chamber of Commerce of the United States of America** (Chamber) is the world's largest business federation.[1] The Chamber represents 300,000 direct members and indirectly represents the interests of more than three million businesses and professional organizations of every size, in every industry sector, and from every region of the country. The Chamber's members include many employers that offer ERISA-governed benefit plans to their employees, as well as companies who fund or administer those plans.

The **American Benefits Council** (Council) is a national non-profit organization dedicated to protecting and fostering privately sponsored employee-benefit plans. Its approximately 435 members are primarily large, multistate employers that provide employee benefits to active and retired workers and their families. The Council's membership also includes organizations that provide employee-benefit services to employers of all sizes. Collectively, the Council's members either directly sponsor or provide services to retirement and health plans covering virtually every American who participates in employer-sponsored benefit programs.

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[1] All parties have consented to the filing of this brief. No counsel for a party authored this brief in whole or in part. No party, no counsel for a party, and no person other than *Amici*, their members, and their counsel made a monetary contribution intended to fund the preparation or submission of this brief.

Each organization has a strong interest in ERISA litigation and regularly participates as *amicus curiae* in this Court and in other courts on issues that affect employee-benefit design or administration, including in *Fifth Third Bancorp v. Dudenhoeffer*, 134 S. Ct. 2459 (2014), and *Santomenno v. Transamerica Life Ins. Co*, No. 16-56418 (9th Cir.).

Amici's members include plan sponsors and fiduciaries that benefit from Congress's decision to create, through ERISA, an employee-benefits system that is not "so complex that administrative costs, or litigation expenses" discourage employers from sponsoring benefit plans or individuals from serving as fiduciaries. *Conkright v. Frommert*, 559 U.S. 506, 517 (2010) (citation omitted). The Supreme Court has recognized that undertaking a "careful, context-sensitive scrutiny of a complaint's allegations" to "weed[] out meritless claims" is an important mechanism for advancing Congress's goal. *Fifth Third*, 134 S. Ct. at 2470-71. Plaintiffs here seek a diluted pleading standard that would authorize discovery based on conclusory assertions about a fiduciary's decision-making process and suggestions of alternative decisions that, with the benefit of 20/20 hindsight, would have been more profitable for plan participants. Plan sponsors and plan fiduciaries alike, including *Amici*'s members that administer, insure, and provide services to ERISA plans, have a strong interest in preventing such an empty standard, which would defeat dismissal in virtually every case.

SUMMARY OF THE ARGUMENT

In enacting ERISA, Congress sought to encourage employers to sponsor employee-benefit plans by affording sponsors and fiduciaries broad latitude to draw upon their experience to make decisions based on their present and future participants' diverse goals and needs. Fiduciaries are faced with numerous decisions in setting up and administering a plan, including how many investment options to make available, the risk levels of those options, the investment vehicles for those options, whether to make any additional services available (such as participant loans or investment-advice services), and which service provider(s) to hire. As to each of these myriad issues, there is a wide range of reasonable options that a prudent fiduciary could pursue.

Given the sheer number of decisions fiduciaries have to make, and the inherent market uncertainty they face when doing so, Congress chose the "prudent man" standard to define the duties that fiduciaries owe to plan participants. 29 U.S.C. § 1104(a). And because ERISA "requires prudence, not prescience," *DeBruyne v. Equitable Life Assurance Soc'y of the U.S.*, 920 F.2d 457, 465 (7th Cir. 1990) (citation omitted), fiduciaries are judged not for the outcome of their decisions but for the *process* by which those decisions were made, *see Harris v. Amgen, Inc.*, 788 F.3d 916, 936 (9th Cir. 2014), *rev'd on other grounds*, 136 S. Ct. 758 (2016).

In recent years, however, plaintiffs' attorneys have filed dozens of ERISA class actions containing *no* allegations about the fiduciaries' decision-making process and instead asking courts *to infer* an inadequate process from allegations that a plan underperformed for some (arbitrarily chosen) period of time.[2] Pleading a plausible ERISA claim requires more: district courts must engage in a "careful, context-sensitive scrutiny of a complaint's allegations" to "divide the plausible sheep from the meritless goats." *Fifth Third Bancorp v. Dudenhoeffer*, 134 S. Ct. 2459, 2470 (2014).

That is precisely what the district court did here. The court examined each of the factual allegations that Plaintiffs contend suggest an imprudent fiduciary process, and concluded that Plaintiffs' allegations did not plausibly suggest imprudence by the Plan. Indeed, the court recognized that the inferences Plaintiffs asked it to draw were undermined by other allegations in Plaintiffs' complaint. The district court's analysis is in line with this Court's post-*Twombly* decisions in other contexts that also involve inference-based claims. *See infra* pp.15-18 (discussing antitrust, viewpoint-discrimination, RICO, and securities cases).

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[2] *See* Gerald E. Gasber, *The Great Litigation Explosion*, Gasber Financial Advisors, Inc. (June 20, 2016), http://bit.ly/2Br7UNo; John Sullivan, *How To Put The Brakes On 401k Ambulance Chasers*, 401K Specialist Magazine (Mar. 2, 2017), http://bit.ly/2o3LdX7 (noting significant uptick in 401(k) lawsuits, which "will stifle innovation"); Thomas E. Clark, Jr., *The Recent Wave of ERISA Litigation Is Turning into a Tsunami* 1-3, 401(k) Advisor (May 2016), *available at* http://bit.ly/2HcXUYt.

At bottom, Plaintiffs suggest that they should be able to unlock the doors to discovery simply by proffering, with the benefit of 20/20 hindsight, alternative fiduciary decisions that would have been more profitable. Plaintiffs' standard could be met in virtually any case, as a plan fiduciary *always* could have made *some* decision that would have proved more profitable; it is not possible to beat the market every time. And allowing plaintiffs to plead claims against an ERISA fiduciary merely by alleging poor performance or by second-guessing a fiduciary's discretionary choice among several reasonable options "would impose high [fiduciary] insurance costs upon persons who regularly deal with and offer advice to ERISA plans, and hence upon ERISA plans themselves." *Mertens v. Hewitt Assocs.*, 508 U.S. 248, 262 (1993). This is precisely what Congress sought to avoid in crafting ERISA.

This Court should reject Plaintiffs' invitation to dilute the pleading standard in ERISA cases and should thus affirm the district court's judgment.

ARGUMENT

I. ERISA Encourages The Creation Of Benefit Plans By Affording Flexibility And Discretion To Plan Sponsors And Fiduciaries.

A. 401(k) Plan Fiduciaries Use Their Experience And Expertise To Make Numerous Discretionary Decisions While Accommodating A Participant Base With Diverse Interests.

When Congress enacted ERISA, it "did not *require* employers to establish benefit plans." *Conkright v. Frommert*, 559 U.S. 506, 516 (2010) (emphasis added). Rather, it crafted a statute intended to encourage employers to offer benefit plans while also protecting the benefits promised to employees. *Id.* at 516-517; *see also* H.R. Rep. No. 93-533, at 218 (1973), *reprinted in* 1974 U.S.C.C.A.N. 4639, 4647 (noting that ERISA "represents an effort to strike an appropriate balance between the interests of employers and labor organizations in maintaining flexibility in the design and operation of their pension programs, and the need of the workers for a level of protection which will adequately protect their rights and just expectations"). Congress knew that if it adopted a system that was too "complex," then "administrative costs, or litigation expenses, [would] unduly discourage employers from offering welfare benefit plans in the first place." *Varity Corp. v. Howe*, 516 U.S. 489, 497 (1996).

Congress also knew that plan sponsors and fiduciaries must make a variety of decisions, often at times of considerable market uncertainty, and in a manner that accommodates "competing considerations." H.R. Rep. No. 96-869, at 67 (1980), *reprinted in* 1980 U.S.C.C.A.N. 2918, 2935. Sponsors and fiduciaries must take into account present and future participants' varying objectives, administrative efficiency, and the need to "protect[] the financial soundness" of plan assets. *Id.* As a result, Congress designed a statutory scheme that affords plan sponsors and fiduciaries considerable flexibility—"greater flexibility, in the making of investment decisions . . . , than might have been provided under pre-

ERISA common and statutory law in many jurisdictions." U.S. Dep't of Labor Opinion No. 81-12A, 1981 WL 17733, at *1 (Jan. 15, 1981). As courts have recognized, the broad discretion conferred by Congress is the "*sine qua non* of fiduciary duty." *Pohl v. Nat'l Benefits Consultants, Inc.*, 956 F.2d 126, 129 (7th Cir. 1992).

Retirement plan fiduciaries draw upon their considerable experience and expertise when making decisions about the investment options to offer to plan participants and any service providers to retain. The members that comprise Chevron's Investment Committee are illustrative: the Committee consists of the company's General Manager for Benefit Plan Investments, the Manager of Reporting & Control, and the Investment Strategist of the company's Treasury Department, all of whom are chosen "because they occupy key positions and/or possess a strong finance and investment background." ER258. This experience is put to good use, as fiduciaries must make numerous decisions that affect plan participants. For example, unless the plan document specifically mandates certain decisions or otherwise limits fiduciary discretion, plan fiduciaries must make decisions concerning:

- the general investment policies for the plan (*i.e.*, whether certain types of investments, such as funds that invest in mortgage-backed securities, will be prohibited);

- the default investment option, if any, for plan participants who have not made a decision about how to allocate the contributions in their individual investment accounts;
- the appropriate quantity of investment options to make available to plan participants (some plans offer a dozen, others offer more than one hundred);
- the risk levels of investment options to offer (ranging from very conservative capital-preservation options simply intended to avoid loss, to aggressive growth strategies for younger employees);
- the investment styles to include (potentially including domestic equity funds, international funds, allocation funds, bonds, and target-date funds, among others);
- the structure of the investment options (such as mutual funds, separate accounts, or collective trusts);
- the share class of investment funds to offer, with certain share classes offering more "revenue sharing"—a common practice in which service providers of mutual funds share a percentage of the fees they receive with the administrative-service provider of a particular 401(k) plan[3]—which can help defray participants' recordkeeping and other administrative costs; and
- any additional services that could be made available to plan participants, such as a self-directed brokerage window, participant loans, or investment-advice services.

Even after those investment decisions have been made, plan fiduciaries must monitor the investment options selected and decide whether, and when, to change investments. And contrary to the refrain of the ERISA plaintiffs' bar, prudent fiduciaries may reasonably decide not to drop investment options from the plan anytime there is some indication of underperformance. Indeed, "chasing

[3] Deloitte Development LLC, *Defined Contribution Benchmarking Survey* 21 (2017) ("Deloitte Benchmarking Survey"), *available at* http://bit.ly/2BW7z6d.

performance" by switching investments at times of underperformance may have a significant *negative* impact on investment returns.[4] Literature suggests that, generally, "a period of above-market performance for a given fund will be followed (eventually) by a period of below-market performance" and vice versa—a concept known as "reversion to the mean."[5] Investing during a time of underperformance could be a way to obtain excellent performance returns when the fund reverts back to or above the mean. And for plan participants who have invested in a particular fund, prematurely switching investments as soon as fund performance drops could negatively impact their retirement accounts, or even their inclination to continue participating in the plan if they prefer buy-and-hold investing. As a result, it is generally a reasonable strategy for fiduciaries to retain funds until performance improves or at least until such time as the fiduciary determines that performance is not likely to get better given market conditions and the fund's investment strategy.

[4] *See generally*, Brian R. Wimmer, Daniel W. Wallick, and David C. Pakula, *Quantifying the impact of chasing fund performance* 1, Vanguard Research (July 2014), *available at* https://vgi.vg/2z3c8Yn (discussing the "lure of performance-chasing" and providing an empirical analysis of why buy-and-hold strategies are more prudent); YiLi Chien, *Chasing Returns Has a High Cost for Investors*, Fed. Reserve Bank of St. Louis (Apr. 14, 2014), http://bit.ly/2EpHLkD.

[5] *Chasing Performance: What It Is and How to Avoid It*, Oblivious Investor (Jan. 1, 2009), http://bit.ly/2ErRoiY.

Plan fiduciaries must also decide whether to outsource plan services (such as recordkeeping) and whether to offer additional elective services (such as participant loan or investment-advice services). If fiduciaries elect to hire service providers, they must decide which service provider(s) to retain, negotiate the compensation for such providers, and determine whether such compensation should be paid on a hard-dollar per-participant fee, an asset basis, or via specialized fees for particular services. Fiduciaries must also determine whether plan services and funds should be coordinated through one vendor—a common practice known as "bundling"[6]—to take advantage of potential discounts, or whether services and funds should be provided by unrelated entities.

Here, too, the decisions must take account of several competing considerations. For example, structuring service-provider compensation on a hard-dollar basis could mean that lower-balance, lower-income employees may shoulder a significantly larger share of the plan's fees, placing disproportionate burdens on a group that already faces barriers to 401(k) enrollment.[7] Thus, fiduciaries may reasonably elect to structure service-provider compensation as a percentage of

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[6] *See* Deloitte Benchmarking Survey 24.

[7] *See* Bureau of Labor Statistics, News Release, *Employee Benefits in the United States - March 2014* 5 (July 25, 2014), http://www.bls.gov/ncs/ebs/sp/ebnr0020.pdf (reporting that only 22% of workers in the bottom quartile wage group participate in retirement benefits, whereas 79% of wage earners in the top quartile do so).

assets under management through revenue-sharing practices, which results in those participants who obtain the greatest rewards from the plan paying a proportionate share of the costs to manage the plan. Fiduciaries may also elect to use a combination of these compensation structures. *See* Deloitte Development LLC, *Defined Contribution / 401(k) Fee Study* 15 (2009), *available at* http://www.ici.org /pdf/rpt_09_dc_401k_fee_study.pdf. As courts have recognized, this compensation decision involves "a pure question of where the burden of recordkeeping costs should be placed—a question open to the discretion of a reasonable plan administrator." *Sweda v. Univ. of Pa.*, No. 16-4329, 2017 WL 4179752, at *8 (E.D. Pa. Sept. 21, 2017).

Fiduciaries must also determine the duration of service-provider agreements and how often to switch providers. This decision also implicates numerous competing considerations, including cost, quality of services, and the need to facilitate a constructive working relationship between the plan and its providers. Most plans work with the same service provider for many years because they value continuity given the disruption and participant confusion that can be caused by switching providers. As of 2017, 41% of plans had a five-year contract with their current service provider and 53% of plans had been with their current recordkeeper for more than 10 years.[8]

[8] Deloitte Benchmarking Survey 24-25.

B. ERISA's "Prudent Man" Standard Affords Broad Discretion To 401(k) Plan Fiduciaries.

Given the breadth of fiduciary decisions made in the face of market uncertainty, Congress chose the "prudent man" standard to define the scope of the duties that these fiduciaries owe to plans and their participants. *See* 29 U.S.C. § 1104(a). And Congress chose this standard with a goal of providing fiduciaries with the flexibility necessary to determine how best to financially manage their plans. *See Fine v. Semet*, 699 F.2d 1091, 1094 (11th Cir. 1983) (noting that a "goal of Congress in holding ERISA fiduciaries to the 'prudent man' standard" was to provide "flexibility" with respect to the financial management of such plans); *supra* pp. 6-7. Neither Congress nor the Department of Labor provides a list of required or forbidden investment options, investment strategies, service providers, or compensation structures. Nor does the "prudent man" standard require fiduciaries to "scour the market to find and offer" the most profitable or cheapest investments and service providers, "which might, of course, be plagued by other problems." *Hecker v. Deere & Co.*, 556 F.3d 575, 586 (7th Cir. 2009). Instead, fiduciaries must make reasonably *prudent* decisions based on the information available at the time according to their own experience and expertise.

The flexibility that Congress provided means that fiduciaries have a wide range of reasonable options for almost any decision they make. There are many administrative service providers (including Chevron's recordkeeper, Vanguard), all of which compete with each other on a range of levels, with different fee structures, service offerings, quality, and reputation.[9] There are also thousands of reasonable investment options with different investment styles and risk levels—nearly 10,000 mutual funds alone,[10] several thousand of which are offered in retirement plans—and nearly innumerable ways to put together a plan that employees can use to save for retirement.

Thus, while ERISA plaintiffs often try to challenge fiduciaries' decisions to offer specific investment options by pointing to less expensive or ultimately better-performing alternatives and then suggesting that the fiduciaries *must have* had an inadequate decision-making process, that is not how the prudence standard operates. There is no one prudent fund, service provider, or fee structure that renders everything else imprudent. Instead, there is a wide range of reasonable options, and Congress vested fiduciaries with the flexibility and discretion to choose from among those options based on their informed assessment of the needs of their particular plan. As the Department of Labor has put it, "[w]ithin the framework of ERISA's prudence, exclusive purpose and diversification

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[9] *See, e.g.*, Chad Brooks, *15 Retirement Plan Providers for Your Business*, Business News Daily (July 14, 2014), http://bit.ly/2GcvDzI; Andrew Wang, *401K Providers: 2016 Top 20 Lists* (July 26, 2016), http://bit.ly/2suEbjC; Healy Jones, *Who are the Top 10 Small Business 401k Providers?*, ForUsAll 401(k) Blog (Jan. 30, 2017), http://bit.ly/2HeKL19.

[10] Investment Company Institute, *2017 Investment Company Fact Book* 19 (57th ed. 2017), *available at* https://www.ici.org/pdf/2017_factbook.pdf.

requirements, . . . plan fiduciaries have broad discretion in defining investment strategies appropriate to their plans." U.S. Dep't of Labor Advisory Opinion No. 2006-08A (Oct. 3, 2006), *available at* http://bit.ly/2o3k06Y.

II. An ERISA Complaint That Lacks Direct Allegations Of Wrongdoing Cannot Rely Solely On Inferences From Circumstantial Facts That Have An "Innocuous Alternative Explanation" Or Suggest "The Mere Possibility Of Misconduct."

As noted above, ERISA's standard for acting prudently "focus[es] on a fiduciary's conduct in arriving at an investment decision, not on its results." *PBGC ex rel. St. Vincent Catholic Med. Ctrs. Ret. Plan v. Morgan Stanley Inv. Mgmt. Inc.*, 712 F.3d 705, 716 (2d Cir. 2013) (alteration in original) (citation omitted). Thus, "the proper question" in evaluating an ERISA claim "is not whether the investment results were unfavorable, but whether the fiduciary used appropriate methods to investigate the merits of the transactions." *Harris*, 788 F.3d at 936 (quotation marks omitted).

Here, Plaintiffs admit that they do not allege any facts regarding Defendants' decision-making process. Pls.' Br. 21. They suggest instead that the district court should have *inferred* that Defendants had an imprudent process simply because there were alternative options that outperformed or had lower fees than those selected by plan fiduciaries—even if there are reasonable explanations for those differences. Pls.' Br. 22, 24. That is not the law in this Circuit. For complaints that lack direct allegations of wrongdoing, this Court has consistently probed the circumstantial facts from which plaintiffs ask it to infer misconduct to determine if those allegations plausibly suggest wrongdoing or simply represent a plaintiff's fishing expedition. ERISA claims should be treated no differently.

A. Claims That Rely On Inferences Of Wrongdoing From Circumstantial Facts Must Allege "Something More" Than Allegations That Are Equally Consistent With Lawful Behavior.

There are numerous areas of the law in which courts must consider whether wrongdoing can be inferred from circumstantial factual allegations to satisfy the pleading standards set forth in *Bell Atlantic Corp. v. Twombly*, 550 U.S. 544 (2007), and *Ashcroft v. Iqbal*, 556 U.S. 662 (2009). This Court recently addressed this issue in *In re Musical Instruments & Equipment Antitrust Litigation*, 798 F.3d 1186 (9th Cir. 2015), an antitrust case. Because the plaintiffs lacked direct allegations of illegal agreements among guitar manufacturers to fix prices, the court explained that it had to determine whether it could plausibly "infer a price-fixing conspiracy" based on allegations of "circumstantial evidence of anticompetitive behavior." *Id.* at 1189, 1193. The court scrutinized each of the plaintiffs' circumstantial allegations to determine whether they plausibly suggested "something more" than lawful parallel conduct, or whether the circumstantial allegations "could just as easily suggest rational, legal business behavior." *Id.* at 1193-98 (citations omitted) (affirming dismissal because the allegations did not support a plausible inference of an anticompetitive agreement).

This Court has taken the same approach in viewpoint-discrimination cases, *Moss v. U.S. Secret Serv.*, 572 F.3d 962 (9th Cir. 2009), RICO cases, *Eclectic Props. E., LLC v. Marcus & Millichap Co.*, 751 F.3d 990 (9th Cir. 2014), and securities cases (even outside the context of heightened pleading), *In re Century Aluminum Co. Sec. Litig.*, 729 F.3d 1104 (9th Cir. 2013). In each of these contexts, when the plaintiffs failed to provide any direct allegations about a foundational element of the claim, this Court carefully scrutinized the circumstantial factual allegations and did not hesitate to order dismissal when those allegations did not support a plausible inference of wrongdoing because they were equally consistent with lawful behavior.[11] As the Court summarized in *Century Aluminum*, "[w]hen faced with two possible explanations, only one of which can be true and only one of which results in liability, plaintiffs cannot offer allegations that are 'merely consistent with' their favored explanation but are also consistent with the alternative explanation." 729 F.3d at 1108. Instead, "[s]omething more is

[11] *See*, *e.g.*, *Moss*, 572 F.3d at 970-972 (claim that Secret Service agents ordered protestors to be relocated because of their anti-Bush message was inadequately pled because the factual allegations were merely "consistent with a viable First Amendment claim," but the "mere possibility" of misconduct is insufficient to reasonably infer a discriminatory intent); *Eclectic Props.*, 751 F.3d at 998-999 (significant increase in real estate prices was "consistent with Defendants' alleged fraudulent intent" but "does not tend to exclude a plausible and innocuous alternative explanation," such as the variability of real estate values and fluctuations in prices over time).

needed, such as facts tending to exclude the possibility that the alternative explanation is true." *Id.*[12]

This Court's decisions recognize, as the Supreme Court did in *Twombly*, the "practical significance" of the Rule 8(a) pleading requirement in cases in which the plaintiff does not present any direct allegations of wrongdoing but instead relies entirely on circumstantial allegations that, even if true, do not necessarily establish unlawful conduct. Such allegations are "much like a naked assertion" of wrongdoing that, "without some further factual enhancement," fall "short of the line between possibility and plausibility of 'entitle[ment] to relief.'" *Twombly*, 550 U.S. at 557 (citation omitted).

As the Supreme Court also recognized in *Twombly*, enforcing the pleading rules is necessary to guard against speculative suits that lead to nuisance settlements. Because "discovery can be expensive" in complex, document-heavy cases (whether arising under antitrust laws or ERISA), the mere threat of discovery "will push cost-conscious defendants to settle even anemic cases before reaching

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[12] Plaintiffs cite *Starr v. Baca*, 652 F.3d 1202 (9th Cir. 2011), in arguing that they need not rule out rational alternative explanations for the circumstantial facts from which they ask this Court to infer an imprudent process. Pls.' Br. 22, 25. But as this Court noted in *Eclectic Properties* when it rejected this same argument, in *Starr* the plaintiff's claims "survived a motion to dismiss by offering facts that tended to exclude the defendant's innocuous alternative explanation." 751 F.3d at 997; *accord Century Aluminum*, 729 F.3d at 1108 (similarly distinguishing *Starr* and stating that "[t]o render their explanation plausible, plaintiffs must do more than allege facts that are merely consistent with both their explanation and defendants' competing explanation").

those proceedings" and encourage plaintiffs with even groundless claims to file suit in the hopes of a settlement. *Id.* at 558-59; *see also Eclectic Props.*, 751 F.3d at 995-996 (noting these fairness concerns). Thus, courts must require factual specificity "before allowing a potentially massive factual controversy to proceed." *Twombly*, 550 U.S. at 558-559 (citation omitted).

B. *Twombly* And This Court's Post-*Twombly* Precedents Should Apply With Full Force In ERISA Cases.

As in the antitrust, RICO, securities, and discrimination cases discussed above, ERISA plaintiffs (including Plaintiffs here) often fail to present any direct allegations of the foundational element of a fiduciary breach claim—an imprudent decision-making process. Instead, plaintiffs ask courts to infer wrongdoing from circumstantial allegations, such as the performance of funds included in a plan lineup compared to other available funds that could have been selected, or the fees of investment options or service providers compared to alternatives in the market. But those circumstantial allegations are often consistent with entirely lawful conduct, particularly given the range of reasonable options available for fiduciaries for any given decision they must make. And when that is true, the claim should be dismissed.

Plaintiffs' allegations in this case that Chevron acted imprudently just because it offered a money market fund in its plan provide a perfect example of this sort of speculation. Plaintiffs argue that this Court can infer an imprudent decision-making process from the decision to offer a money market fund rather than a stable value fund, on the theory that stable value funds tend to provide higher returns to investors. Pls.' Br. 28-32. This argument reveals two fundamentally misguided assumptions: first, that the only prudent investment is the one that earns the greatest investment returns; and second, that there is a single, optimal investment option and the failure of a fiduciary to select that investment reveals imprudence.

To the contrary, there is a wide variety of prudent options in any investment style, and price and performance are just two of the many factors for a fiduciary to consider. The Department of Labor has recognized that for plan fiduciaries deciding to offer a capital-preservation fund—an option in which "the primary goal is to preserve capital and prevent loss in a portfolio"[13]—both money market funds *and* stable value funds may be appropriate investment vehicles. Default Investment Alternatives Under Participant Directed Individual Account Plans, 71 Fed. Reg. 56,806, 56,807 (Sept. 27, 2006) ("[T]he Department recognizes that investments in money market funds, stable value products and similarly performing investment vehicles may be prudent for some participants or beneficiaries."). Both stable value funds and money market funds are also widely

[13] *Preservation Of Capital*, Investopedia, http://bit.ly/2EoHOwY (last visited Feb. 14, 2018).

offered in 401(k) plans.[14] And both vehicles are prudent potential options for good reason—they offer different benefits and drawbacks. While stable value funds have in recent years provided greater returns due to historically low interest rates, Defs.' Br. 26, they often contain greater restrictions regarding withdrawals (particularly during layoffs or bankruptcies), and they are less portable for plan participants who may wish to transfer them into alternative investment options.[15] And given the significant worker mobility levels in the United States—which is much higher than in other parts of the world—portability of funds may be an important consideration for plan fiduciaries.[16]

Plaintiffs' argument also ignores that the purpose of capital-preservation options is *not* to maximize investment returns: they are intended to be *safe* options, not long-term growth vehicles. "In plain English, capital preservation is a code word meant to recognize that some piles of money are not designed to grow larger.

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[14] *See* U.S. Dep't of Labor, *Advisory Council Report on Stable Value Funds and Retirement Security in the Current Economic Conditions*, http://bit.ly/2FDL2ZY (last visited Feb. 14, 2018) (testimony by Susan Graef, head of the Stable Value Management Group at Vanguard, that one-third of Vanguard clients offer money market funds, one-third offer stable value funds, and one-third offer both).

[15] *See* U.S. Gov't Accountability Office GAO-11-291, *401(k) Plans, Certain Investment Options and Practices That May Restrict Withdrawals Not Widely Understood* 23-24, 28 (Mar. 2011), *available at* https://www.gao.gov/new.items/d11291.pdf.

[16] *See generally* Aleksandra Iwulska, *Internal mobility: The United States*, *in* Golden Growth, Restoring the lustre of the European economic model 97-101 (World Bank 2012), *available at* http://bit.ly/2BW9szX.

If they do, that's icing on the cake, but it isn't why you've set them aside . . . . Instead, they have been saved solely to be there when you need to reach for them." Joshua Kennon, *Understanding the Role of Capital Preservation in Investments*, The Balance (Feb. 3, 2018), http://bit.ly/2mlZV9E. Indeed, people often use these funds as a hedge against volatility by, for example, allocating only small portions of their retirement savings into them, or placing money into the funds for a short period of time when markets are particularly unstable.[17] The funds are not intended to "significantly affect retirement savings." 71 Fed. Reg. at 56,807. Given the purpose of capital-preservation options, it is entirely rational (and well within a fiduciary's discretion) to select money market funds, with their greater portability and fewer withdrawal restrictions, instead of or in addition to stable value funds. As a result, the bare fact that a plan offers a money market fund cannot plausibly suggest that plan fiduciaries acted imprudently.

Plaintiffs' attempt to base imprudence on the Plan's retention of a single mutual fund (the Artisan Small Cap Value Fund) that allegedly underperformed its peers fails for similar reasons. As noted above, *supra* pp. 8-9, chasing performance by transferring investments from lower-performing to higher-performing options often leads to worse returns over time because periods of

[17] *See, e.g.*, Darla Mercado, *If you're near retirement, here's your safe harbor from market volatility*, CNBC, Feb. 6, 2018, http://cnb.cx/2EbdllS; Fidelity, *What are money market funds?*, Fidelity Learning Center, http://bit.ly/2o53Gmb (last accessed Feb. 13, 2018).

underperformance *and* periods of overperformance tend to revert to the mean. Thus, it is perfectly consistent with lawful, responsible fiduciary behavior to hold an underperforming fund during down periods—particularly if the fund had a prior history of significantly outperforming its benchmark during periods of market volatility—for sufficient time to allow a fiduciary to determine whether the fund's performance will likely trend back upward. And Plaintiffs' own complaint demonstrates that that is exactly what happened: Defendants ultimately removed the Artisan Fund in early 2014 after a period of evaluation, ER220 ¶ 82, which belies Plaintiffs' conclusory assertion that Defendants were not monitoring the fund. *See Eclectic Props.*, 751 F.3d at 998 (no inference of wrongdoing where the alternative lawful explanation can be inferred "from Plaintiffs' own complaint").

Plaintiffs' suggested inferences regarding the use of mutual funds rather than separate accounts, the selection of retail share classes of mutual funds, and the use of asset-based rather than hard-dollar fees all suffer from similar problems. As explained in Section I.A., *supra*, each of these decisions requires fiduciaries to balance competing considerations and diverse participant preferences. The decision to offer retail share classes of mutual funds and pay recordkeeping expenses using an asset-based, revenue-sharing model—rather than to offer alternative investment structures that would require participants to pay separate hard-dollar recordkeeping fees—involves a discretionary judgment about who should shoulder the greater burden of plan recordkeeping expenses. If an asset-based revenue-sharing model is chosen, the burden falls more heavily on participants with higher account balances. If a plan offers investment structures that do not pay revenue sharing (*e.g.*, institutional share classes of mutual funds or separate accounts), then all participants must pay the same hard-dollar fee, which disproportionately affects participants with smaller account balances. Neither choice is necessarily right or wrong, and neither choice provides any basis to infer that plan fiduciaries lacked a sound decision-making process.

The same reasoning applies to a plan fiduciary's decision to offer mutual funds rather than separate accounts. Plaintiffs superficially suggest that mutual funds are necessarily an imprudent option because separate accounts are cheaper. But fiduciaries do not look only at price when making an investment decision. They must also take into account the preferences and varying sophistication of their participant base. And although separate accounts may generally be less expensive, they are subject to fewer regulatory safeguards for investors, offer less portability of funds for participants exiting a plan who may wish to retain their investments, and are not as familiar to less-sophisticated participants. *See Loomis v. Exelon Corp.*, 658 F.3d 667, 671-72 (7th Cir. 2011); Defs.' Br. 31. Here, too, the decision is not between a prudent choice and an imprudent one, but rather between separate accounts' cost savings and the numerous benefits of mutual funds—"the most popular investment vehicle among U.S. households." Bernice Napach, *Why Mutual Funds Are the Most Popular Investment for US Households: ICI*, ThinkAdvisor (Oct. 13, 2017), http://bit.ly/2CjwfRO. Once again, the mere fact that a fiduciary chose one reasonable option over another is not suggestive of an imprudent decision-making process.

In short, this Court should continue to take the approach it adopted in *Musical Instruments*, *Eclectic Properties*, *Moss*, and *Century Aluminum*. Just as in those cases, the Court should carefully scrutinize circumstantial allegations in ERISA complaints to determine whether they are plausibly suggestive of wrongdoing, or whether they are equally consistent with rational, lawful behavior and therefore do not satisfy the *Twombly* pleading standard.

C. Allowing Hindsight-Based Disagreement With Discretionary Fiduciary Decisions Would Encourage Meritless Lawsuits And Discourage Employers From Offering Employee Benefits.

There are also compelling practical reasons for applying the same probing inquiry of circumstantial allegations in ERISA cases that this Court applies in antitrust, RICO, and discrimination cases. ERISA fiduciaries making discretionary decisions are at risk of being sued for breach of the duty of prudence seemingly no matter what decision they make. Plaintiffs sue fiduciaries for failing to divest from risky or dropping stock,[18] or for failing to *hold onto* such stock because high risk can produce high reward.[19] Some plaintiffs allege that it is imprudent for a plan to offer more than one investment option in the same style,[20] while others complain that including *only one option* in each investment style is imprudent.[21] In many cases, plaintiffs allege that fiduciaries were imprudent because they should have offered Vanguard mutual funds,[22] while here Plaintiffs complain that Defendants were imprudent *because they offered* Vanguard mutual funds.[23] Some plaintiffs allege that plans offered imprudently risky investments,[24] while others allege that fiduciaries were *imprudently cautious* in their investment approach.[25] And in some

[18] *In re RadioShack Corp. ERISA Litig.*, 547 F. Supp. 2d 606, 611 (N.D. Tex. 2008) (plaintiffs alleged that defendants failed "to divest the plans of all RadioShack stock . . . despite the fact that they knew the stock price was inflated").

[19] *E.g.*, *Thompson v. Avondale Indus., Inc.*, No. Civ.A.99-3439, 2000 WL 310382, at *1 (E.D. La. Mar. 24, 2000) (plaintiff alleged that fiduciaries "prematurely" divested ESOP stock).

[20] *See, e.g.*, *Sweda*, 2017 WL 4179752, at *10.

[21] *See*, *e.g.*, Am. Compl. ¶ 52, *In re GE ERISA Litig.*, No. 17-cv-12123 (D. Mass. Jan. 12, 2018), ECF No. 35.

[22] *See*, *e.g.*, *Moreno v. Deutsche Bank Ams. Holding Corp.*, No. 15 Civ. 9936 (LGS), 2016 WL 5957307, at *6 (S.D.N.Y. Oct. 13, 2016); *George v. Kraft Foods Global*, *Inc.*, No. 08 C 2799, 2011 WL 5118815, at *8 (N.D. Ill. Oct. 25, 2011).

[23] ER227 ¶ 108.

[24] *E.g.*, *In re Citigroup ERISA Litig.*, 104 F. Supp. 3d 599, 608 (S.D.N.Y. 2015), *aff'd sub nom.*, *Muehlgay v. Citigroup Inc.*, 649 F. App'x 110 (2d Cir. 2016); *PBGC*, 712 F.3d at 711.

[25] *See Brown v. Am. Life Holdings*, *Inc.*, 190 F.3d 856, 859-60 (8th Cir. 1999) (assuming without deciding that "the fiduciary duty of prudent diversification can

instances, fiduciaries have simultaneously defended against "diametrically opposed" theories of liability, giving new meaning to the phrase "cursed-if-you-do, cursed-if-you-don't."[26]

Courts have recognized this dilemma, noting that ERISA fiduciaries often find themselves "between a rock and a hard place," *Fifth Third*, 134 S. Ct. at 2470, or on a "razor's edge," *Armstrong v. LaSalle Bank Nat'l Ass'n*, 446 F.3d 728, 733 (7th Cir. 2006). And the Supreme Court has instructed lower courts that "careful, context-sensitive scrutiny of a complaint's allegations," through a motion to dismiss, is the appropriate way to accomplish the "important task" of "divid[ing] the plausible sheep from the meritless goats." *Fifth Third*, 134 S. Ct. at 2470-71.

Without this careful scrutiny, ERISA plaintiffs would be permitted to impose serious discovery burdens on plan fiduciaries based on speculation. If ERISA plaintiffs were allowed to survive dismissal merely by pointing to

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be breached by maintaining an investment portfolio that is *too safe and conservative*"); Compl., *Barchock v. CVS Health Corp.*, No. 16-cv-61, (D.R.I. Feb. 11, 2016), ECF No. 1 (alleging plan fiduciaries breached the duty of prudence by investing portions of the plan's stable value fund in conservative money market funds and cash management accounts).

[26] *E.g.*, *Evans v. Akers*, 534 F.3d 65, 68 (1st Cir. 2008) (involving claims that fiduciaries breached ERISA duties by maintaining a "heavy investment in Grace securities when the stock was no longer a prudent investment" and noting "[a]nother suit challenging the actions of Plan fiduciaries" that "asserted a diametrically opposed theory of liability"—"that the Plan fiduciaries had imprudently *divested* the Plan of its holdings in Grace common stock despite the company's solid potential to emerge from bankruptcy" (citation omitted)).

alternative decisions that, with the benefit of hindsight, could have produced more favorable outcomes, then the "important mechanism" of the motion to dismiss "for weeding out meritless claims," *Fifth Third*, 134 S. Ct. at 2471, would be toothless. Plaintiffs' attorneys will always be able to identify an investment option that performed better or had lower fees, because there are thousands of investment options and numerous service providers that compete in the marketplace.

Given the "ominous" prospect of discovery in ERISA actions and the "probing and costly inquiries" that discovery entails (including the need to retain expensive fiduciary and financial experts), *PBGC*, 712 F.3d at 719, the superficial approach to analyzing ERISA complaints that Plaintiffs seek would "push cost-conscious defendants to settle even anemic cases," *Twombly*, 550 U.S. at 559, if not lead to outright "settlement extortion," *PBGC*, 712 F.3d at 719 (citation omitted). And ERISA plaintiffs could exploit that standard to target the largest and most generous plan sponsors, like Chevron, in the hopes of pressuring the company into settling. *See, e.g.*, Tom Anderson, *These 10 companies offer the best 401(k) plans*, CNBC, Feb. 23, 2017, http://cnb.cx/2EoDUQV (identifying Delta Air Lines and Chevron as companies with "highly rated" 401(k) plans); *see also* Order, *Johnson v. Delta Air Lines, Inc.*, No. 17-cv-2608 (N.D. Ga. Dec. 12, 2017), ECF No. 53 (dismissing complaint that challenged investment options and recordkeeping services for the Delta Air Lines 401(k) plan).

Given these perverse incentives, adopting anything less than the "careful . . . scrutiny" of ERISA complaints prescribed by the Supreme Court in *Twombly* and *Fifth Third* would create precisely the types of "undu[e]" administrative costs and litigation expenses that Congress intended to avoid in crafting ERISA. *Conkright*, 559 U.S. at 516-17. Even sponsors and fiduciaries with an exemplary decision-making process would face enormous settlement pressure due to the "ominous" costs of discovery in ERISA class actions. *PBGC*, 712 F.3d at 719.

For the twenty percent of plan sponsors that are small or mid-sized businesses—a number that has already decreased in recent years[27]—there is a real risk that costs inflated through the need to defend meritless lawsuits may discourage them from offering, or continuing to offer, benefits under ERISA—just as Congress feared. *See Conkright*, 559 U.S. at 517. And for those that continue to sponsor plans, Plaintiffs' diluted pleading standard and the strike suits it would encourage would crimp the flexibility that Congress provided to fiduciaries; raise the costs of services, indemnification, and insurance; and ultimately divert resources from other key aspects of employee-benefit programs, such as 401(k) matching contributions or subsidization of healthcare premiums.

[27] *See* Deloitte Benchmarking Survey 6 (reporting that more than one-third of plan sponsors surveyed by Deloitte in 2013 and 2014 employed 500 or fewer employees, while just one-fifth employed the same number of employees in 2017).

Neither ERISA nor the pleading standards articulated by the Supreme Court support such a result. This Court's approach to Rule 12(b)(6) motions in ERISA cases must be careful to guard against it.

CONCLUSION

For the foregoing reasons, the decision of the District Court should be affirmed.

Dated: February 15, 2018

Respectfully submitted,

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Dated: February 15, 2018

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I hereby certify that I electronically filed the foregoing with the Clerk of the Court for the United States Court of Appeals for the Ninth Circuit by using the appellate CM/ECF system on February 15, 2018.

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